

# General Discussion: What Is Natural About Unemployment? Policy Sources and Implications of Labor Market Rigidities

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*Chair: Christina D. Romer*

**Mr. Haltiwanger:** Giuseppe Bertola's paper opened up a very old and provocative debate about the role of rigidities. He noted that this is an old topic that we've been chatting about for a long time. He noted that this topic was discussed at the 1994 Jackson Hole conference. I want to talk about a key fact that has emerged since 1994 that I think will help us understand the cost of rigidity, even though there may be still some benefits. Back in 1994, I don't think we yet understood the key implications of rigidities for productivity. So what we've learned especially since the 1990s, and now not only for the United States, but for the whole world, is the enormous dispersion in productivity across businesses in narrowly defined sectors. Chad Syverson nicely summarized this in a 2011 *Journal of Economic Literature* paper. In the United States, the interquartile range of productivity is around 30 log points inside very narrow industries. That represents enormous potential for allocative efficiency to be important. In efficient economies, resources will be moving away from the 25th percentile business to the 75th percentile at a high rate with that 30-log-point gap. This suggests that if this is distorted, then the economy will be performing poorly. We started to get those new facts in the early 1990s, for the United States. And early on, people often said, well maybe that's because the U.S. is at the technological

frontier. And if an economy is at the frontier with lots of innovation and experimentation then maybe this accounts for the substantial dispersion in productivity within industries. And so the argument was made that maybe this isn't so important in countries that aren't at the frontier. Actually, as the evidence has emerged, if anything, the dispersion in productivity inside narrow sectors is even larger in emerging economies. And the very nice work of Hsieh and Klenow has helped us understand why the kind of distortions that Mark Bilts was talking about are actually going to raise within-industry dispersion rather than lower it. So, that's a huge potential cost of rigidities in the steady state. The point is that flexibility is critical to be able to allocate resources efficiently and I think that there is increasing evidence that the reason some countries have such low GDP per capita is because of misallocation distortions. Moreover, one part of the relevant distortions in this context are the labor market rigidities that you are talking about. So, then let's think a little bit about crises. As we discussed yesterday, flexibility also perhaps gives you resilience to be able to adjust to crises. And so it's not just in a steady state, that you want such flexibility. And having said that, one thing I'm very sympathetic with is your remarks about policy responses are often too late on these dimensions. We've seen over and over in countries a crisis comes along and suddenly they want to do labor market reforms then. That's probably not a good idea because indeed what often happens is, we see an enormous burst of job destruction and the environment's not so conducive, from aggregate demand conditions and other kinds of distortions, for any job creation to occur in those countries. And so I agree with you that thinking about when you try to address the rigidities, it's not so clear a crisis is the right time to do it.

**Ms. Buch:** Thanks for a very engaging presentation and this discussion. I particularly liked the fact that you tried to link labor markets and financial stability and monetary policy, as I believe it is really useful to think about these issues concurrently. Now the question I would like to ask you is—I wasn't quite clear on your thoughts on policy coordination; yesterday we heard something about policy coordination, so would it really be feasible to have separate goals for policy price stability, financial stability and a well-functioning

labor market and then somehow bring them all together? Or are you saying that each policy should work toward its own target, that we would be willing to make adjustments and then show some flexibility as conditions change on other markets. That to me seems the more plausible way to go. And then perhaps a few words on Germany. I'm glad to hear that Germany carried out reforms, and you've painted a very positive picture. We indeed implemented labor market reforms that I think were very successful in terms of reducing structural unemployment. The main aim was to reduce unemployment benefits and make it easier for firms to hire workers. Our labor laws have therefore remained largely unchanged, so I would say I don't know whether the glass is half-empty or half-full. It's not that I'm disparaging about what we have achieved. I think we've been very successful, but I think we still have some way to go in Germany.

**Mr. Furman:** I thought it was a very interesting paper. I think the general point of things not all good, not all bad, makes a certain amount of sense. I think going further with that, trying to disaggregate labor market rigidities and not just treat them all in one bucket, but be more nuanced about differences between different types. And you take something like unemployment insurance and building on, which John Haltiwanger said. I think a lot of that. You want to look not to the macro but to the micro in questions of what it does to people's attachment to the labor force. What it does of their ability, and this goes directly to John's point, of making a better match. Not just jumping into the first job that comes along, but taking a little bit longer, and Raj Chetty has work in this regard. So I think a lot of the benefits one would find in so-called rigidities, you'll find in that type of micro literature as opposed to some of the macro stabilization that you're focusing on in this paper. And I think that micro literature will lead you to more of a differentiation between different sources of rigidities and in particular ones that are more on the tax and transfer system as opposed to labor market regulations.

**Mr. von Wachter:** This is an extremely interesting paper because it has an even-handed approach to rigidities, whereas economists, when it comes to rigidity, often have only the right hand. But there are some possible benefits to rigidities and it's good to discuss those.

Now, one issue I had, I wondered whether you'd comment on that, that rigidity is such a broad term. For example, an important part of the reallocation of workers between jobs that happens is mostly due to job-to-job mobility that tends rise in booms. This mobility is mostly voluntary and is likely to happen despite firing restrictions. In fact, the evidence, at least from Europe, appears to be that firing restrictions do not have a very strong effect in productivity or unemployment. At the same time, there is a lot of evidence that job displacements in recessions are extremely costly. And there appears to be little or mixed evidence that job destruction in recession has strong productive reallocation effect. So maybe if you could comment on the different types of rigidity and how they interact with business cycle conditions that would be helpful.

**Mr. Bertola:** I agree with the remarks. So many other things matter for productivity today. I think it's difficult to isolate employment protections effect. I mean, unless you make an experiment, I mean it is possible, but difficult. It's true. Till von Wachter is right. The evidence is nuanced. It is not a prima fascia strong effect. One thing that relates to the other question, it's true, different level market rigidities, different level market institutions are different. But they are also similar. For example, employment protection legislation, if you think of these rigidities as a second-best reaction to financial market imperfections, unemployment insurance shifts the burden of these negative shocks from workers to a collective scheme. Employment protection shifts the burden from workers to the employers and it makes a little bit of sense when the employers have better financial market success than workers, which is probably true in underdeveloped commercial markets.

On Germany, again, and very quickly replying to the question. On Germany, successful, yes, but if you look at the pictures, it's not a *finanche*, meaning unemployment was down, but inequality goes up, OK, so trade-off. And it's a very good business for Germany in the particular situations to take this reform. Maybe this was not explained very well to the people what the reason was and now they're having second thoughts. It's not completely clear. What I think would be good in terms of policy coordination around Europe, would be to

have a good explanation of the reasons why reforms need to happen. A little bit deeper than Germany, the leader, therefore everybody else has to do it, which is not very convincing. It doesn't work. Finally, I think in terms of questions to me, the cost of rigidities I know are big. But the benefits of rigidities need to be taken into account. And one thing that happened in the evidence, things we know now, we didn't know so well in '94, is both there is lot of inequality and productivity across clients, but also that wage inequality has been rising. And again, not me particularly, I'm on the good side of the rise of wage inequality, so I'm not personally worried. But if you listen to people, some people are worried about that. That's the other side. Residual wage inequality is the other side of getting people to move from one job to the other. And again, I'm not taking sides. I'm just pointing out that the good and bad are coming together, and again, the message I wanted to convey is that if you look at the good and the bad, then you can, having discovered important productivity effects, convince people that the market reform is good. Financial markets have also been improving so well. It's become so much easier to get a mortgage and a credit card and so on. And this was the old speech. And now we need to discuss a bit more I think. Not now, but, it's the time when these kind of financial markets are developing so well. That's not incompletely true.

**Mr. Davis:** Thank you for the provocative paper and remarks. You stressed that rigidities have benefits and costs and that there's trade-offs in the choice. That's certainly sensible, but two things I wanted to get your reaction to. One, it seems to me that formation of the common currency union—by removing the ability of countries to tailor their monetary policies and exchange rates to country-specific conditions—is a strong argument for moving toward more flexibility of labor markets. Specifically with respect to wage-setting, because the common currency implies the loss of an important macro policy instrument.

Second, there's a hidden danger in policy regimes that involve a high level of employment protection, a danger beyond the usual factors stressed by economists. You hinted at this in some of your remarks: An environment with high levels of employment protection comes with harder-to-get jobs, less fluidity in labor markets.

Workers who have jobs look around and they see, correctly, that if I lose my job, it's quite hard to find another one. I think it's much harder for them to recognize that the difficulty of finding a job is partly a consequence of the policy regime in which they live. And so it then becomes very hard to persuade people that there are benefits to moving to a more flexible regime because all they see is, well, I might lose my job, and then it's going to be very hard to find a comparable job. So it seems to me that there's a political economy dynamic that makes it very difficult for a country with a rigid labor market regime to adapt to the kinds of changes and conditions that you talked about in your remarks.

**Mr. Mooslechner:** There is a small group of countries in the euro area—I am thinking of countries like Germany, the Netherlands, Austria—where the unemployment rate is even well below U.S. rates, and at the lowest level in the European Union in general. If you look at these countries, it is interesting that you find a complete different set of labor market structures there, labor market rigidities for example. What you see is a completely different institutional setting, but it seems to work well in terms of labor market outcome in all three countries. So what's your interpretation concerning these differences, which probably tell us that a one-fits-all flexibility approach might not be the only way to success and out of the present situation?

**Mr. Spriggs:** As I mentioned to you aside, my European Union colleagues would love you since they normally are told that they have to have U.S. labor market standards which practically don't exist. So I think that that gets to this other issue, which is the total view, which is in some way the part that's missing, right? Which is, what was the total deal? So if you ask people in Spain and in Portugal, fine, you're asking us to take a pay cut, but we're not seeing job gains in return for the pay cuts. And we don't see prices fall. And we see financiers doing quite well. So it's not that all of us are being asked to sacrifice equally. So the other part of the equation gets to the social cohesion question about what is in the labor market regulation. Labor market regulations exist to solve problems of excesses. And, they balance worker and business interests in resolving those excesses. Those agreements and the processes to develop the regulations create social

cohesion, and underlying faith the system works for everyone. That's another problem that's trying to be solved, which is an issue of social cohesion. So if you could talk about the sort of total social contract implicit in what's being solved by these labor market regulations and the extent to which we can maintain social cohesion in Greece and Spain and Portugal as they go through these transformations.

**Mr. Rogerson:** I'd like to echo Jason Furman's comment, which is, you make the point that there's good and bad, but I think nobody would really argue with that, so I think it's important to dig into the details. I do think we need to think about packages of policies and institutions and very loosely speaking, there's some insurance type arrangements and then there are some arrangements which we think influence the way resources are allocated from the productive point of view. And I think we should think about packages like this and just as an example I would throw out the so-called flexicurity system of Denmark, which is aimed at promoting allocative efficiency, but also providing in the background, some insurance arrangements, understanding that part of the cost of reallocating resources does involve disruption of earnings in such individuals. And we don't have complete insurance markets in the background. So I think those ideas are out there and are well understood, so I think it's important to push more in terms of thinking about packages.

**Mr. Bils:** For rigidities as a way for us to have social insurance, I was struck by something President Draghi had said yesterday, which I will repeat here. When you have these restrictions to try to maintain certain people's employment, you're going to crowd out the people who are in the more flexible relationships. The most flexible people are the ones who don't have any job yet, or are coming out of school. So there's this crowding out. And then, if you think about it as a social insurance, I think it is worth calculating who are being benefited by the rigidities. What's their consumption? What's their standard of living versus the people you're crowding out? I've never seen that calculation. It's not obvious that the people you're helping would necessarily be on the lowest parts of the consumption distribution. They are those facing a cut in consumption. So it becomes a matter of whether it's consumption or rate of growth in consumption that's

being insured. There's other means of redistribution. If you're saying we're not happy with the political economy of taxing and redistributions, we want to put in other distortions, I just don't know if that's up to economists.

*Mr. Bertola:* Again, so I go backward and Mark Bilal, I know meaning, this is not going to be good for everybody in the same way, that's clear. But, it's a bit naïve to think the young are those who are damaged by these rigidities. You may or may not know that in France, the young and employed are those that are most opposed to minimum wage cuts. Why? Because they have a perspective. They say at least when I find a job, it will be a good job. And it's symmetric what happens in the U.S. People are happy to see somebody very rich because they have a little bit of a chance in their mind of being the winner. So, it's a bit more complicated to get the consensus than just say well, you're young, so you're a loser. Well, on a career perspective it is not as obvious.

Answer to Richard Rogerson, packages, flexicurity, yes, but again, the message which I know is not a very deep mess, it depends. Flexicurity looked great in between 2001 and 2007. Everybody was so happy to be in federal flexicurity without qualifying the message by saying, well the damage, can't do it because they are a small and cohesive country, they all look the same, they have very similar last names. These are things that, I'm not kidding, meaning every country is a little bit different, and they are small. As was pointed out that small countries are better able to get a good labor market outcome; small villages also, small regions also. That's OK. At the same time as we want, because we live in a complicated economy, in a modern world, we want to be able to go beyond small and have a discussion of policies. The message about packages, so the package used to be looking good, now it's being replaced, and the German system of getting people to do a good job with their young, and then if there is a temporary problem, the employer will be subsidized to keep them on because it did well in the recession, while flexicurity did extremely poorly. Denmark was in trouble because unemployment went way up. Every country, every period is a little bit different. I'm not saying

that therefore we cannot say anything. I'm saying we can analyze the situation, and see if we can get something better.

On the small regions and small countries I just mentioned, the rigidities and equilibrium is still there, that's true. But again, it's about having more than one tool, meaning, if you just say, let's liberalize the labor market, but you leave the professions regulated, if becoming a taxi driver is not as easy as it is in the U.S., then they're not going to get consensus. People will say, you're right, they will say come on, start from somewhere else, start from the bankers, start from the university professors. Don't start from the poor workers, you see. I completely agree it's a package, I agree with the interventions, it's a package. And we can find something more sensible, but you will not be always the same, not everywhere. And one thing, just because it is discussed in the paper briefly, it is true that when we went to EMU, we had the common currency. The one big advantages of flexibility and there was a whole program at the ECB where I was involved marginally about studying the changes in the labor market behavior with the EMU. It's true. I know, it's true. It's a fact, it sense that it makes sense and it's true in reality. If you have decentralized labor market institutions in a common market, you will see more flexibility.

